United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-1004

To be argued by
JOHN S. MARTIN, JR.

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-1004

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI, and
JOSEPH SCANSAROLI,

Defendants-Appellants.

REPLY BRIEF OF DEFENDANT-APPELLANT, ANTHONY M. NATELLI

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REPLY BRIEF OF DEFENDANT-APPELLANT, ANTHONY M. NATELLI

Introduction

This is an appeal from a conviction in a criminal case where (1) the jury had originally announced that it was deadlocked and returned its verdict of guilty only after hearing a rereading of the court's reckless disregard charge in response to its second request for a definition of "knowingly", and (2) the trial judge concluded from his assessment of the evidence that each of the appellants was "absolutely sincere when you say that you did not believe that you did anything wrong on this audit or audits for National Student Marketing" (A. 284). Despite these clear indications that this was an extremely close case in which there is good reason to question whether the Government proved beyond a reasonable doubt that these defendants "willfully and knowingly" prepared false financial statements, the Government blithely asserts that the appellants' contentions that the evidence was not sufficient "are wholly without merit" (Gov. Br. p. 26).

In order to support this proposition the Government has submitted a brief which does not simply draw "justifiable" inferences from the facts, *United States* v. *Freeman,* 498 F.2d 569, 571 (2d Cir. 1974), but rather resorts to hyperbole which is totally unsupported by the record. Compare *United States* v. *Aloi,* 2d Cir., Doc. No. 74-1220, decided January 31, 1975, slip opinion, p. 6066.

This is not a negligence case, nor is it a civil case under Rule 10b-5. It is a criminal case in which the issue is whether the defendants "knowingly and willfully" made a materially false statement in a proxy statement filed with the SEC. In our original brief we have demonstrated that there is serious doubt that the Government proved

these essential elements beyond a reasonable doubt or that the jury would have returned such a verdict were it not for the errors in the court's charge (See Natelli Brief, pp. 38-73). Rather than meet these arguments on the merits, the Government has attempted to support these convictions by presenting a statement of the facts which completely distorts the record and is replete with factual misstatements.

Before turning to a detailed comparison of the facts stated by the Government in its brief with the actual record below, it may be useful to consider what the Government has attempted to do by its distortion of the evidence. From a reading of the Government's brief the Court would conclude that the Government had proved by "devastating" (Gov. Br. 29) expert testimony that these accountants were engaged in wholesale criminal activity on behalf of NSMC during which they continually violated generally accepted accounting principles. The Government further would have the court believe that fearing discovery of their misdeeds the accountants engaged in a "cover-up" which culminated in the preparation of fraudulent financial statements for the proxy statement. The truth is directly to the contrary.

The Government's Misstatement of the Facts

Although the Government dwells at length on the 1968 audit and the alleged impropriety of the method of accruing income used by NSMC and the audit procedures followed at that time, there was no proof at trial that Mr. Natelli's judgments were made for any corrupt purpose or were not made in good faith. Indeed, while the Government repeatedly rants about Natelli's decision that it was appropriate for the company to accrue income at the time it obtained a commitment from a major corporation to participate in a variety of the programs NSMC offered, that accounting judgment made by Natelli in 1968

was the same as the accounting decisions made by another (CPA, Michael Sullivan, three months earlier when in preparing NSMC's statement of earnings for the nine-months ended May 31, 1968 he used this method to accrue $260,000 of such income* (Tr. 469-482, Natelli Exs. B & C).** Thus, whatever laymen may think about the accounting method which Natelli accepted in auditing the statement for the year ended August 31, 1968, it was a method used by the company earlier with the approval of a totally different independent CPA. In addition, and despite the repeated assertions in the Government's brief that the CPA's who testified as defense witnesses did not support appellant's accounting decisions, Leon Otkiss, the PMM SEC reviewing partner, testified that he considered this method of accruing income to be appropriate (Tr. 1747). Thus, there is no basis for even suggesting that Natelli's approval of NSMC's use of percentage of completion accounting was improper. Indeed, the grand jury which conducted a lengthy investigation in this case did not charge that there was anything wrong with the use of percentage of completion accounting.

Similarly, the Government completely distorts the record in an attempt to convey to the Court an impression that what the defendants did in their work as auditors of NSMC was proven overwhelmingly to be patently at odds with generally accepted accounting principles and that none of the CPA's who testified as defense witnesses supported what appellants did. The fact—which may come as a shock to the Court after reading the Government's brief—is that the Government did not call a single witness for the purpose of eliciting expert testimony. The only "expert" testimony elicited during the Government's case came during the re-direct examination of the witnesses

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* Also, as the Government is aware, Arthur Andersen & Co., NSMC's prior auditors, had sanctioned the use of this same method of accounting for the accruing of income on written contracts.

** References in the form "E" are to pages in the Exhibit Appendix.

John Buck and Ian Dingwall. Buck, a CPA and the comptroller of NSMC, indicated that he could not answer the Government's questions without reading the applicable accounting authorities and testified further that the issues raised by the Government never occurred to him at the time the proxy statement was prepared (Tr. 690-694). Dingwall was an SEC accountant who, under the law of his home state, had obtained his certificate as a CPA while still in college, had worked for only four years in public accounting and had apparently been with the SEC for less than a year. He was called by the Government simply to introduce a number of summary charts. Although on redirect examination he did make some unequivocal statements about certain accounting principles, his re-cross examination demonstrated his lack of familiarity with applicable accounting principles and that the authorities on which he relied were not the type of pronouncements which would be recalled by the average accountant without some research and study (Tr. 1306-1308, 1359-1362).

More important, however, an analysis of the deviations from generally accepted accounting principles alleged by the Government demonstrates that its claims either misstate the accounting principle at issue or involve technical matters which did not occur to any of the accountants who worked on the proxy statement. At page 25 the Government states that none of the accounting witnesses* called

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* Since the Government did not call any expert witnesses to attempt to prove what it would now have the Court believe it proved overwhelmingly—the defense did not call any witness to testify as an expert. This case was tried not as an accounting case, but as a criminal case where the issue is good faith irrespective of compliance or lack of compliance with generally accepted accounting principles. *United States* v. *Simon*, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970). Moreover, if the Government wished to prove criminal knowledge by proof of lack of compliance with generally accepted accounting principles, it should have called an expert witness for that purpose, since it had the burden of proving its case beyond a reasonable doubt.

by the defense offered any testimony to rebut the Government's proof that Natelli and Scansaroli had deviated from generally accepting accounting principles by:

> "(1) subtracting $750,000 of written-off 1968 NSMC sales from the figures for other, later acquired, companies (Tr. 1315, 692-693, 567);
>
> (2) netting the extraordinary item for a newly discovered tax credit against the write-off of some of the NSMC 1968 sales losses, an ordinary loss item (Tr. 1307); and
>
> (3) failing to disclose the concededly material post-period adjustment which resulted from writing off retroactively $750,000 of 1968 sales (Tr. 1304-1308, 690-692)." (Footnote omitted.)

An analysis of the testimony, not only of the defense witnesses but also of the Government witnesses, demonstrates that this assertion is not supported by the record. Since the response to item (1) above involves some understanding of items (2) and (3) we shall treat the items in reverse order.

(3) *The failure to disclose the $750,000 retroactive write-off of 1968 sales.* Natelli's decision in this regard was concurred in at the time and supported at the trial by Leon Otkiss, a more senior partner of PMM who had been assigned to review the proxy statement because "he was one of the most technically proficient partners of the firm." (Tr. 1741-1752). Similarly, the testimony of the Government witnesses, John Buck, a CPA and NSMC's comptroller in 1969, and Bernard Kurek, who, though not a CPA, taught accounting and was NSMC's chief financial officer, was that each of them was aware of these write-offs and did not consider disclosure necessary (Tr. 684-685, 629).

had been known to Scansaroli since May. Johnston also concluded that other adjustments were necessary. Johnston and his immediate superior, Bill Colona, drafted a very somber comfort letter, containing $884,000 of downward adjustments. (GX 26*; Tr. 926-934). It did not, however, contain the entire story. That was known only to Natelli and certain employees of NSMC including Scansaroli. Natelli, of course, knew of the Pontiac write-off and thus knew of an additional $1 million dollars of loss not disclosed in the comfort letter. Natelli also knew of the "weird" Eastern "sale". Natelli knew of the track record of the company's earnings as based upon "unbilled accounts receivable," of which $3.3 million had been booked, and over $2 million had been written off. And Natelli knew that decisions had to be reached that day as to whether the INC acquisition could go through, and whether PMM's general counsel or its professional practices partner would reveal NSMC's comfort letter adjustments to the SEC. Natelli did not disclose what he knew to his superiors at PMM. As a result, INC's representative, although startled by the comfort letter they did receive at the closing, did not get the whole truth in context, and thus permitted the deal to close. (Tr. 1056-1061). The fraud was completed.**

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* Not printed in Exhibit Volume of Appendix.

** At the end of the brief, are reproduced GX 65-2, GX 65-10, GX 65-11, GX 65-14 and GX 65-15 in evidence, which summarize and illustrate the facts proved at trial. GX 65-2 shows the materiality of the 1968 unbilled accounts receivable to NSMC as without them, the company had a $65,000 loss, but with them, reported a $388,000 profit. GX 65-10 places side by side an early draft of the false footnote, Natelli's handwritten changes, and the final footnote as changed by Natelli. GX 65-11 summarizes the omissions and misstatements in the final version of the false footnote. GX 65-14 summarizes the performance of NSMC on the unbilled accounts receivable during 1968 and the first half of 1969, showing the amounts written off and known to be bad or uncollectible. GX 65-15 summarizes the contracts uncovered as bad by Scansaroli (J.S.) in May 1969, rediscovered by Oberlander (D.H.O.) in August, 1969, and disclosed by Johnston and Colona in the comfort letter.

The Defense

(a) General Defense

As a matter of general defense, the defendants each called character witnesses. Two testified for Natelli, three testified for Scansaroli, and one testified for both. In addition, Natelli elicited information regarding other accounting services performed during the NSMC engagement which restricted NSMC management's claims of profit with respect to matters unrelated to the Indictment.

(b) Motive (The 1968 Audit)

Both Natelli and Scansaroli sought to contest the Government's argument that the proxy statement was a cover-up of their unprofessional work in the 1968 audit by asserting the propriety of their accounting work in 1968.

Scansaroli at first claimed that he had done everything he could to audit the contracts in progress. (Tr. 1608, 1611-12).

Further cross-examination extracted concessions from Scansaroli that:

(1) Scansaroli had lost direct control of the confirmation procedure by permitting NSMC salesmen to dial the phone to reach the person to be contacted (Tr. 1612-13);

(2) Scansaroli failed to confirm with the "contract" debtor (Tr. 1614);

(3) Scansaroli had unwittingly spoken to NSMC's printing contractor in the belief he had contacted an advertising agency (Tr. 1614 *et seq.*, and 1621-2);

(4) Scansaroli failed to keep adequate work papers (Tr. 1624-6);

(5) Scansaroli failed to examine NSMC salesmen's time records and instead simply assumed any work done had been done before the August 31 year-end (Tr. 1628);

(6) With respect to the Clairol "sale", the largest of the "sales" booked ($500,000 of the $1.7 million booked at year end 1968), Scansaroli apparently never asked to see a proposal by NSMC or any work-product at all produced by NSMC for Clairol (Tr. 1650);

(7) Scansaroli booked as $138,000 of "sales" a "commitment" from Syntex Corporation which specified no amount of money whatever and no obligation by NSMC or Syntex to perform or pay for any services, and which was dated two months after year-end, called for NSMC to make a proposal thereafter as to what services NSMC might perform, and contained a complete money back guarantee from NSMC to Syntex. (Tr. 1657-60; GX 3 at E29-30).

Finally, after lengthy cross-examination, Scansaroli conceded that rather than having done "everything possible," he had, instead, been "far too easily satisfied." (Tr. 1660).

Natelli, the partner in charge of the audit, authorized the use of telephone confirmations; however, he explained that he did not read in detail the workpapers which revealed the above facts (Tr. 1975, 1972).

(c) Defendants' False Testimony

With regard to the substantive matters at issue at the trial, the defendants gave testimony which was so self-servingly inconsistent with the documentary evidence and with their own pre-trial testimony as to warrant incriminatory inferences. Among the more flagrant examples were the following:

Scansaroli had twice, before trial, testified that the reason telephone confirmations (rather than the traditional written confirmations) were used during the 1968 audit was that he knew the situation was "touch and go" i.e., that NSMC had not yet assured itself that it had firm

commitments from the clients. This testimony (quoted earlier in this brief) was given before both the SEC in 1971 and the Grand Jury in 1973. However, at trial, Scansaroli admitted that if the situation was touch-and-go he should not have booked the sales at all, and gave new excuses for his poor confirmation procedures. When confronted with his prior testimony, Scansaroli claimed that his memory had improved. (Tr. 1600-03, 1607-08).

Natelli denied at trial that on December 9, 1968 he had told a roomful of NSMC employees (and Scansaroli) that thereafter, NSMC could only book commitments if they were "firm enough to confirm in writing." Natelli's denial on the stand was directly contradicted by a memorandum, prepared the day after the statement, which quoted him as above, and which was sent to all NSMC salesman for their guidance. (Tr. 209, 1995-9; GX 7).

Scansaroli emphatically denied, at trial, having told anyone—even in jest—that he feared losing his certificate to practice as a CPA. (Tr. 1572, 1679-81) This evidence was flatly contradicted by the unequivocal testimony not only of Kurek (as corroborated by GX 14) but even of Natelli that Scansaroli had made such comments not once, but several times (Tr. 237, 2032-8, 1933-1933A).

Natelli denied having told Kurek that the "people working under him are uncomfortable with this situation [unbilled receivable accounting] and if anything were to happen, their certificates and careers would be at stake." This denial was completely inconsistent with a memorandum prepared the day of the conversation, quoting him as above, which was sent to the president of NSMC to inform him of this important concern. (GX 14; Tr. 233-4, Tr. 2027-9). In addition, Natelli conceded on cross-examination that the write-offs had been "professionally embarrassing." (Tr. 2029) Natelli also denied any recollection of making the statements at NSMC's June 9, 1969 finance committee meet-

ing quoted earlier in this brief, and disputed their plain import despite the fact that the quotations were taken from a verbatim transcript of portions of the meeting made by a secretary who was there taking shorthand notes (GX 16; Tr. 238-246; 2013 *et seq.*).

The defendants offered mutually inconsistent versions with respect to the circumstances surrounding the tax credit. Thus, while Scansaroli had told the SEC, under oath in 1971, that only he and Natelli had been involved in the calculation of the tax credit (Tr. 1686), Scansaroli told the trial jury that the tax credit was "in effect" computed by Carol Raimondo, a PMM tax department employee. (Tr. 1687) Mrs. Raimondo testified that she did not calculate the tax credit. (Tr. 1396).

Neither defendant could properly account for the fact that there were no work papers in existence showing the calculation of the tax credit. Scansaroli emphatically testified that there were no calculations made in arriving at the tax credit and therefore no workpapers had ever existed. (Tr. 1687-9) This was flatly contrary both to his own prior sworn testimony before the SEC (Tr. 1688) and to Natelli's testimony that there had been calculations but that he could not find the workpapers. (Tr. 2044).

(d) Consultations With Otkiss, the SEC Reviewing Partner

By way of alibi, Natelli claimed to have cleared the nondisclosure of the 1968 write-offs with PMM's SEC reviewing partner Leon Otkiss (Tr. 2193).*

However, it appeared from the cross-examination of Otkiss and Natelli that Natelli had deceived Otkiss by not

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* Scansaroli had testified in the Grand Jury that he and Natelli had decided "on their own hook" not to disclose the write-offs (Tr. 882-884a).

giving Otkiss the critical facts needed in order to evaluate the question. Thus, Natelli told Otkiss that there were write-offs of up to $700,000 of sales but omitted to state the additional facts known to him that $1 million of 1968 sales and an additional $1 million of 1969 sales had been written off, and that virtually the entire balance of the company's unbilled receivable sales were uncollected and uncollectible. Natelli further deceived Otkiss by stating that the sales write-offs resulted from the unethical acts of a single salesman, Ronald Michaels,* omitting to state the facts known to him that other salesmen's sales totalling approximately $1.3 million dollars were also written off as no good. (Tr. 1764-70; 2082-90).

(e) The Comfort Letter

Natelli claimed that his good faith was apparent from the disclosure of certain NSMC losses in the INC comfort letter, delivered some four weeks after the filing of the proxy statement. To establish this claim, Natelli called four PMM employees, Otkiss, Colona, Holton and Earle.

As noted above, from their testimony and Natelli's it appeared that one John Johnston, a PMM staff accountant, uncovered in the course of his work during September, 1969 certain "bad" or uncollectible contracts previously noted by Scansaroli in May of 1969 and again brought to Scansaroli's and Natelli's attention by another PMM staff accountant, Douglas Oberlander, in August of 1969. Johnston uncovered other problems in NSMC's books and reported them all to his immediate superior William Colona. Colona and Johnston then drafted a comfort letter stating adjustments

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* The defendants never explained how the "unethical acts" of Michaels which NSMC had told them about — taking kickbacks from NSMC's *suppliers* — in any way resulted in the invalidity of the commitments Michaels had brought in from NSMC's *clients* (purchasers), where no kickbacks could be involved.

which completely wiped out NSMC's 1969 first three quarter earnings as stated in the proxy statement. When confronted with this state of facts, Natelli told Colona to call Otkiss the next morning, the day of the closing. (Tr. 1780-86; 912-13; 917-936). Otkiss recommended bringing Holton, a member of PMM's professional practices committee, into the discussions. (Tr. 1940). Holton, in turn, consulted with PMM's legal counsel Victor M. Earle, III. During the course of the day, two amendments to the comfort letter were suggested underlining the seriousness of the adjustments. Neither of these was suggested by Natelli. (Tr. 1802-5; GX 67*).

One of the topics under consideration during the day was whether to go to the SEC.** When consulted as to whether to bring the facts to the attention of the SEC, Natelli had a meeting with Scansaroli, at that time an NSMC employee, and then told his superiors the adjustments were the results of "honest mistakes." (Tr. 2103-6; GX 67). At no time did Natelli tell his superiors, including the SEC review partner and the firm's general counsel, that an additional $1 million dollars had been secretly written off during the first three quarters of 1969 (the period which was the subject of the comfort letter) and not disclosed anywhere. Nor did Natelli tell his superiors that overall write-offs of unbilled receivables totalled over $2 million out of $3.3 million booked, that the $1 million Pontiac commitment had been written off, or that the Eastern Airlines contract had suddenly surfaced under "weird" circumstances at 3:00 a.m. while the proxy statement was being printed up. Accordingly, the SEC was not informed of the facts, the comfort letter did not contain the facts, and the INC board permitted their company to be acquired for NSMC stock.

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* Not printed in Exhibit Volume of Appendix.

** Natelli did *not* claim as he has suggested in his brief at pp. 34 and 41 that he himself recommended going to the SEC (Tr. 1945, 2102-2103).

(f) Accountant Testimony

Defendant Natelli called eight witnesses. Six of these were certified public accountants, and one of the CPA's was, in addition, a university professor of accounting. Scansaroli called five witnesses, of whom three (including one who also testified for Natelli) were CPA's. One of these was a college professor of accounting. Including the defendants, then, no fewer than ten certified public accountants testified for the defense. Not one of these offered any testimony to rebut the Government's proof that Natelli and Scansaroli had deviated from generally accepted accounting principles by

(1) subtracting $750,000 of written-off 1968 NSMC sales from the figures for other, later acquired, companies (Tr. 1315, 692-3; 567;);

(2) netting the extraordinary item for a newly discovered tax credit against the write-off of some of the NSMC 1968 sales losses, an ordinary loss item (Tr. 1307); and

(3) failing to disclose the concededly * material post-period adjustment which resulted from writing off retroactively $750,000 of 1968 sales. (Tr. 1304-1308; 690-692).

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* Natelli conceded that accountants do not adjust a prior period's figures unless the adjustment is material (Tr. 2123). Buck's testimony was to the same effect. (Tr. 692). Both the retroactive write-off of $750,000 in sales and the tax credit were prior period adjustments.

ARGUMENT

POINT I

The Evidence Was More Than Sufficient To Support The Jury's Guilty Verdicts As To Both Defendants.

Both Natelli and Scansaroli claim that the evidence was insufficient to support the jury's verdicts of guilty as to them. These claims are wholly without merit. Both defendants omit to disclose to this Court in their briefs important segments of the Government's proof. For example, neither defendant has mentioned the Government's uncontested expert testimony that both defendants, in preparing the false proxy material, violated generally accepted accounting principles in three different and important respects. Defendants' failure to discuss this proof here renders their arguments frivolous. As neither defendant has adequately stated the facts proved at trial, for the Court's convenience, the facts are briefly re-summarized below, in chronological order, as to each defendant separately. These facts show that the jury was fully justified in its verdicts.

1. The proof as to Natelli

The jury was amply justified in finding that Natelli wilfully made, caused to be made, or aided and abetted in the making of the materially false footnote and the materially false nine months earnings statement.* The proof is summarized, below, in chronological order.

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* The jury was properly instructed that it could return a verdict of guilty if satisfied of the proof as to either the allegation concerning the footnote or the allegation as to the nine-months earnings statement (Tr. 2340).

(a) The 1968 Audit

Natelli was the partner in charge of the 1968 audit of NSMC. As such, Natelli personally agreed to adjust NSMC's books, long after year end, to add $1.7 million of newly found "sales." Natelli knew that this adjustment changed NSMC's loss into a large profit (Tr. 181-2).

Natelli directed that those sales were to be audited by telephone after management complained that the more usual procedure—written confirmations—might result in NSMC losing the sales (GX 2; Tr. 193; 1838-9; 1607-8; 1601-2). Natelli stated that he had neglected to read carefully the work papers which disclosed Scansaroli's complete failure to audit the sales properly (Tr. 1972). Within a period of months, Natelli learned that over $1 million of these $1.7 million of "sales" had been written off, and that the balance were uncollected and uncollectible. The jury was entitled to consider the above facts as providing a powerful motive to cover up those losses.

(b) The write-offs

In late April or early May, 1969 Natelli, with Scansaroli, was informed that NSMC had written off approximately $345,000 in 1968 sales, and wanted to write-off an additional $678,000 of these sales. Natelli and Scansaroli were asked, by NSMC accountants, how to accomplish this write-off (Tr. 633-9). The write-off which Natelli and Scansaroli designed did not result in any reduction of published NSMC earnings, as it improperly netted the lost earnings against a purportedly newly discovered tax credit (Tr. 645). The unrebutted expert proof was that it was a violation of generally accepted accounting principles to net the extraordinary item relating to the tax credit with the write-off of earnings, an ordinary item (Tr. 1307). The jury was further entitled to find the tax credit itself a fraudulent entry. The tax credit appeared at exactly the right time, and in precisely the right amount to absorb

the earnings loss relating to the sales write-offs. And when the SEC began to investigate, Natelli and Scansaroli acknowledged there was no such credit after all (Tr. 1373-6). Finally, the defendants' conflicting stories regarding this item of proof furnished further evidence from which the jury was entitled to conclude that the tax entry was part of the defendants' scheme to cover up.*

(c) The False Footnote (Paragraph Three of Count Two)

Three months later, in preparing the proxy statement, Natelli took further steps to bury the truth regarding NSMC's write-offs.

The historical earnings summary in the proxy statement was a "pro forma," or "pooled" statement (GX 25 at 21). That is, it showed NSMC's prior years as if NSMC had, during those prior years, owned certain businesses it had acquired in only the past few months. The footnote, which is the subject of paragraph three of Count Two, had as its function to reconcile NSMC's prior earnings as

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* Natelli argues at Point III (p. 75) of his brief, that it was reversible error to permit the Government to prove the fraudulent nature of the tax credit. This point is frivolous, as the false tax credit was inextricably bound up in the write-off of NSMC sales which the indictment alleged the defendants falsely omitted to disclose in the footnote. (GX 13 at p. E98). As Judge Tyler expressly found, ". . . the minute you get into those figures you have got to consider the tax figure." (Tr. Dec. 20, 1974 p. 15). In any event, this proof was admissible as evidence of the defendants' knowledge or intention to deceive. *United States* v. *Papadakis*, Dkt. No. 74-1847 (2d Cir., January 10, 1975), slip op. 1231, 1241; *United States* v. *Deaton*, 381 F.2d 114, 117 (2d Cir. 1967); *United States* v. *Bozza*, 365 F.2d 206, 213 (2d Cir. 1966); Rule 404(b), Fed. R. Evidence. Natelli's argument is nothing more than a bold assertion that the Government must list in the indictment every item of its proof or suffer reversal. The law in this Circuit is settled to the contrary. *United States* v. *Koss*, 506 F.2d 1103, 1113 (2d Cir. 1974).

reported in the pooled historical earnings summary in the proxy statement with the figures previously reported to the public. It was the only place in the proxy statement which an investor might look at to examine the actual performance of NSMC, the core company, apart from other companies' earnings it had subsequently bought up with its stock.

In preparing this footnote of audited figures, Natelli omitted to disclose the fact that $1 million (over 20%) of NSMC's sales of its most recent year, 1968, had been written off. Instead, Natelli personally scratched out every reference to the fact that there had been write-offs (GX 17; Tr. 563-567; 1197-1211; GX 65-9 and GX 65-10). And in addition, Natelli deliberately subtracted NSMC's lost sales resulting from the write-offs from the later acquired companies' figures (Tr. 890-3; 2062-8). By so doing, Natelli deliberately overstated NSMC sales by $750,000 (15%); and understated the pooled companies by $750,000 (12%).

The Government proved without contradiction that this subtraction was wholly improper and a violation of generally accepted accounting principles (Tr. 1315; 692-3; 567). The Government further proved, by unrebutted expert testimony, that Natelli (and Scansaroli) had violated generally accepted accounting principles by retroactively writing-off sales without disclosure of the fact (Tr. 1304-8). This devastating proof fully justified the jury's guilty verdict. As this court stated in *United States* v. *Simon*, 425 F.2d 796, 807 (2d Cir. 1969), *cert. denied*, 387 U.S. 1006 (1970): "The jury could reasonably have wondered how accountants who were really seeking to tell the truth could have constructed a footnote so well designed to conceal the shocking facts."

(d) The False Nine-Month Earnings Statement (Paragraph Four of Count Two)

Before completing his work on the NSMC nine-month earnings statement, Natelli knew that NSMC had on three occasions juggled its books to add large earnings to periods long before closed. The first was when Natelli and Scansaroli booked $1.7 million of 1968 "sales" after year-end 1968. The second was when NSMC booked a million-dollar-plus "sale" to Pontiac as part of its six month report, months after that period closed. And the third was when Natelli and Scansaroli booked the Eastern "sale" as part of the nine-months statement, months after the period had closed (Tr. 2056-7). The effect in each case was to very materially improve NSMC's earnings picture just as it was about to be made public.

Natelli knew from the circumstances surrounding the Eastern "sale" that it was fraudulent. The "sale" was first announced at 3:00 A.M. at the printer's plant where the proxy statement was being printed, and it emerged just in time to plug a hole in the earnings statement caused by the Pontiac write-off. In a memorandum prepared at the Pandick Press, Natelli noted: "To go and *replace* G.M. contract with this would be really wierd [sic]." (emphasis in the original) (GX 21; Tr. 257-63; 651-55). Natelli knew that NSMC had booked, and had announced to the public, $3.3 million of unbilled accounts receivable "sales" while secretly writing off over 2 million of them. Natelli knew that virtually the entire balance was uncollectible (GX 16; Tr. 238-246; GX 65-14). Natelli knew that an additional specified several hundred thousand dollars in "contracts" were no good and should be written-off. In his memorandum prepared at the Pandick Press, Natelli noted "Seem to be problems 100-200 m on other contracts, we have not previously discussed. Would be very material

to results" (GX 21; Tr. 2093-4).* Natelli knew that NSMC's salesmen had proved repeatedly unreliable and that the salesman, Kelly, who suddenly produced the Eastern "commitment" letter, dated three months after the alleged "sale", was the same salesman responsible for the deficient Pontiac commitment. Finally, Natelli knew, as early as March, 1969, that NSMC would have a loss of over $1.5 million without certain acquisitions and unbilled sales which Randell hoped to obtain (Tr. 222-3; GX 10A).

Natelli, despite his knowledge of these facts, participated in the preparation of the nine-month earnings statement. In view of Natelli's inclusion in this statement of the Eastern contract, and his refusal to take out the known bad contracts, the jury was amply justified in finding this earnings statement deliberately false.

Natelli argues, at p. 47 of his brief, that the Government failed to prove that the Eastern contract was in fact not earnings of the first nine months of 1969. This argument overlooks the facts, proved by the Government, that NSMC had no record of expenditures on this "contract", no record of ever having billed Eastern for services on this "sale," and not one scrap of paper from Eastern other than the suddenly-produced letter (which was never checked with Eastern) to indicate Eastern's interest in such a sale (Tr. 572, 1149-50). In the circumstances, this was more than sufficient to meet the Government's burden that it was false and misleading to book Eastern as sales and earnings for the period ending in May, 1969. The Govern-

* Natelli argues at p. 50 of his brief "the Government offered no testimony that Oberlander's workpapers were brought to Natelli's attention"; and that "there was no evidence that any of these [bad sales noted by Oberlander] were called to Mr. Natelli's attention." This argument is misleading in the extreme, and it omits the proof on the point. Natelli's knowledge of the bad contracts which Oberlander had scheduled was proved by Natelli's memo (GX 21) and Natelli's admissions at Tr. 2093-4.

The Government's contention that it proved the falsity of this contract because it showed there was no record of expenditures on this contract and no billing to Eastern for services ignores the testimony that these facts are totally consistent with the percentage of completion method of accounting used by NSMC. The percentage of completion method was adopted because it was impossible to segregate by individual contract the substantial overhead costs incurred by the company in maintaining and supporting its account executive staff (Tr. 1746-1747, 1836-1838, Natelli Ex. B). Thus the fact that none of these costs had been allocated to the Eastern contract was of no significance, particularly in light of Natelli's review of the time logs of the account executive involved which indicated he had spent over 100 hours working on this contract prior to the end of May (Natelli Ex. J). Equally meaningless is the lack of any billing on this contract since the detailed program to which the Eastern letter referred, and which Natelli examined, indicated that the mailings and postings of advertising was to take place in the future. Thus, there was nothing to indicate that the letter which Kelly delivered to Natelli was anything other than that which it appeared to be on its face—a legally binding commitment from Eastern Airlines to use $820,000 worth of NSMC's programs.

But more important, the Government's suggestion that it was prevented by defense objections from proving that this commitment was fraudulent is another gross distortion of the available evidence. The fact that proffered evidence was rejected because the Court found that it was not relevant to prove that there was anything fraudulent about the Eastern contract* cannot possibly justify the Govern-

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* The court properly excluded evidence that eight months after the proxy was prepared NSMC disbanded the campus marketing division and therefore had to write off a large part of the Eastern contract because NSMC would not be able to perform the services. The evidence was that Eastern never disavowed this commitment and, indeed, as the Government knows well, Eastern Airlines confirmed this commitment in writing during the audit for the period ended August 31, 1969.

ment's failure to produce relevant evidence to sustain its claim that the Eastern commitment was "phony". Indeed, the fact is that the Government deliberately refused to produce the evidence it needed to prove the Eastern commitment was fraudulent because to do so would be to prove that Natelli and Scansaroli were the victims of a complicated scheme involving Randell, Kelly and Mullen, the Eastern Airline executive, which had as its sole purpose the deception of the auditors. The proof of this scheme would have demonstrated to the jury, however, that there was no basis for the Government's repeated assertions that the auditors, Natelli and Scansaroli, were involved in a scheme with Randell (Tr. 66-67, 2265). Thus, the Government deliberately chose not to offer this necessary testimony.

That there was ample evidence of such a scheme to deceive the auditors is found in the fact that shortly after this trial concluded, the Government indicted Thomas Mullen, the Eastern executive who signed the commitment letter, on a charge of conspiring with Randell and Kelly. The indictment charged:

> "a) MULLEN repeatedly recommended to Eastern's management that they substantially increase their purchases of NSMC's services.
>
> b) MULLEN stated to the press and pulic that Eastern was very satisfied with NSMC's performance.
>
> c) MULLEN provided NSMC with documents purporting to confirm that Eastern had committed itself to greatly increased purchases of NSMC services.
>
> d) MULLEN helped RANDELL and KELLY hide from the public the fact that Eastern had neither bound itself to utilize nor would it ever utilize anywhere near the amount of services NSMC claimed to have sold Eastern, and the further fact that he had received personal payments from RANDELL (without Eastern's knowledge and consent)."

United States v. *Mullen,* Indictment No. 74 Cr. 172). The fact that the auditors, Natelli and Scansaroli, were the victims of this conspiracy is clearly reflected in the transcript of the guilty pleas of both Randell and Kelly. Thus in pleading guilty prior to the trial herein, Kelly advised the court:

> "I obtained this confirmation letter from Mr. Mullen of Eastern Airlines, dated August 14, 1974, and delivered it to Mr. Randell.
>
> However, Mr. Mullen had also requested a letter from NSMC to the effect that Eastern Airlines could cancel part or all of the contracted services before December 31, 1969.
>
> This letter, which was proposed, was signed by Mr. Randell and I delivered it to Mr. Mullen.
>
> I subsequently spoke to the accountants relative to the nature of the services to be provided under the Eastern Airlines contract.
>
> I did not inform them of the existence of the conditional letter which was given to Mr. Mullen, although I had reason to believe that they did not see or know of this letter and had they known, would not have booked the Eastern transaction. (A. 112-113).

See also the transcript of Randell's guilty plea set out at A. 125.

Since Kelly and Randell had pleaded guilty prior to trial and were available to testify as witnesses for the Government (A. 307) to prove that the Eastern commitment was "phony" (although specifically designed to deceive the auditors), it is absurd for the Government to contend that they were prevented from proving this essential fact by a proper ruling of the court excluding patently irrelevant evidence or that they had proved the fact circumstantially. See *United States* v. *DiZenzo,* 500 F.2d 263 (4th Cir. 1974); *United States* v. *Gardner,* 475 F.2d 1273 (9th Cir.), *cert. denied sub nom. Le Boulanger* v. *United States,* 94 S. Ct. 178 (1973). See also *United States* v. *Charles Pfizer & Co.,* 367 F. Supp. 91 (S.D.N.Y. 1973).

Indeed, in light of its indictment of Mullen and the information it had obtained from Randell and Kelly as to their deliberate deception of Natelli, the Government should be estopped from asserting that Natelli knew the Eastern contract was fraudulent.

In any event, we now turn to an examination of the items on which the Government relies to prove that Natelli was not the victim of the Randell, Kelly and Mullen conspiracy and that he did know this contract was fraudulent.

As to the alleged falsity of the nine-month statement of earnings the Government says the proof was sufficient because (1) the recording of the Eastern contract was the third time NSMC had actually recorded income in its books after the date on which the accounting period ended, (2) Natelli knew that this sale was fraudulent from the circumstance that this sale was first announced at the printers at 3 A.M. and Natelli himself described it as "weird", (3) Natelli knew NSMC had booked $3.3 million of unbilled receivables and had written off $2 million of them, (4) the notes Natelli made at the printer (Gx 21) state "Seems to be problems 100-200 m on other contracts we have not previously discussed. Would be very material to results." (5) Kelly, who delivered the Eastern commitment letter to Natelli at the printer, was the salesman responsible for the deficient Pontiac commitment, (6) Natelli knew in March NSMC would lose $1.5 million without acquisition and unbilled receivables. Again we shall treat each of the Government's arguments in order.

(1) The fact that entries are made in the company's books after the date on which a period closes is not an unusual event in the life of an accountant (Tr. 774-776). This was particularly true during the audit for the year ended August 31, 1968, since Kurek and Chapman told Natelli and Scansaroli at their first meeting in August 1968 that NSMC's records were a month or two behind (Tr. 141-143).

(2) The evidence was not that the Eastern commitment was first mentioned at 3 A.M. at the printer;

Natelli testified that Randell told him earlier in August he was expecting a letter from Eastern acknowledging this commitment (Tr. 1913-1914). The Government's distortion of the use of the word "weird" in Gx 21 is fully discussed above. See pp. 10-11, *supra*.

(3) When the components of the $2 million write-off to which the Government makes reference throughout the brief are examined, it is evident that the fact that these write-offs had occurred did not cause Natelli to know that the Eastern contract was fraudulent. To the extent that this $2 million figure was brought to Natelli's attention, it had three principal components: (a) the Michaels write-off of some $750,000; (b) approximately $212,000 of sales written off by the company and described by Buck as "immaterial" (Tr. 659-660);* and (c) $1,000,000 accrued in 1969 on the Pontiac contract which Natelli insisted should be written off from the unaudited statements because the letter supporting it was not a legally binding contract. Since the uncontradicted evidence was that Michaels was fired because of his unethical conduct in 1969, there was no reason for Natelli to suspect that Michaels and Randell had conspired to create the fictitious sales that Michaels reported.** The write-off of the other

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* At various places throughout its brief the Government attempts to create the impression that the company wrote off $354,000 of August 31, 1968 sales. (See, *e.g.* pp. 9, 27). It does this by adding to the $212,000 for the audited figures $70,200 accrued on the Listerine contract reported by Michaels, which at other places in its brief it lumps with the other Michaels' contracts, and some other contracts which the company recorded in the first quarter of the subsequent fiscal year and which the company later wrote off.

** The Government suggests in a footnote at p. 23 that it cannot see how the fact that Michaels was discharged for taking kickbacks from suppliers relates to his reporting of fictitious sales. The important fact is, however, that Michaels had been fired and that when another account executive reported that the sales Michaels reported were fraudulent, this report was viewed as totally consistent with Michaels' character. In addition, since Michaels had been discharged and the company was no longer accruing income on oral commitments, there was ample reason to believe that a similar problem would not occur in the future.

"immaterial" amount of oral contracts would not give Natelli cause for alarm since, at his insistence, NSMC had changed its procedure and was then accruing income only on written commitments, and he had been assured by the NSMC executives at the June 9th meeting that NSMC's experience with written commitments was good and none had to be written off—a fact fully supported by the "charts" Kurek brought to that meeting (Gx. 15, Tr. 520-527). Finally, there was never any suggestion that Pontiac was not "planning" to use $1,200,000 of NSMC programs —indeed, in August 1969 the Pontiac executive involved confirmed to representatives of Interstate that Pontiac did plan to participate in NSMC's programs (Tr. 672-674, 1071). Natelli's reason for insisting that this be written off was simply that the letter was not in the legally binding form that he had been insisting on since December of 1968 (Tr. 518-520, 530-535, 1870-1871, 672-673). In these circumstances, and given the fact that Randell was offering to fly Natelli to Detroit to meet with the Pontiac official involved (Tr. 673), there was no reason for Natelli to suspect that the Pontiac commitment was "fraudulent" and to therefore assume that the Eastern commitment was fraudulent.

(4) This item is another distortion of Gx. 21 by taking out of context a statement made when Natelli was considering whether it would be necessary to reprint the proxy to delete the Pontiac figures (see pp. 10-11, *supra*). It is apparent from the memo that the "100-200 m" contracts Oberlander was questioning were not considered material in themselves but only in connection with the $400,000 difference between the Pontiac and Eastern commitments. In any event, Kurek testified that the decisions that were made as to the contracts Oberlander questioned were made in complete good faith (Tr. 405-408).

(5) Since as noted above there was no reason for Natelli to suspect that there was anything fraudulent about the

Pontiac letter, there was no basis for him to be suspicious of Kelly.

(6) As noted above, this item is simply based on a distortion of the March meeting (See pp. 8-9, *supra*).

Materiality

In our original brief we demonstrated that the absence of footnote discussion of the write-off of the Michaels contracts was not material (See original brief, pp. 42-46, 70-71).* The Government attempts to respond to this argument by seeking to amend the indictment and thus having this Court judge the issue of materiality on the basis of a charge made by the Government, but not by the grand jury. Thus the Government argues that our argument as to materiality "is frivolous" because "NSMC had no earnings in 1968 without unbilled receivables . . . [and] had no earnings in the first nine months of 1969 without unbilled receivables." But the indictment did not charge that it was wrong for NSMC to use percentage of completion accounting, i.e., "unbilled receivables". Indeed, as noted above, Otkiss testified this method was appropriate (Tr. 1747). In addition, since the "unbilled receivables" and "accrued costs" on the contracts in progress were separately set forth on the balance sheet printed in the proxy statement, any reader interested in the effect of "unbilled receivables" on profits would have had that information readily available (Gx. 25, pp. E212-E213). In any event, since the grand jury did not charge that the proxy statement was false in including unbilled receivables, the materiality of the items actually questioned by the grand jury cannot be sustained on that basis. *Russell* v. *United States*, 369 U.S. 749 (1962); *Stirone* v. *United States*, 361 U.S. 212 (1960).

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* As noted above, the $212,000 of other oral contracts recorded in the August 31, 1968 financial statements and subsequently written off by the company were characterized by one of the Government's "expert witnesses" John Buck, as "immaterial".

POINT II

The trial court erroneously instructed the jury on the issue of knowledge and on other critical factual and legal issues.

In its attempt to uphold the court's instruction to the jury in this case, the Government places heavy reliance upon the alleged similarity between the portions of the court's charge challenged here and the court's instructions in *United States* v. *Simon*, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970). As we shall demonstrate below, in doing so it fails to recognize that there are fundamental differences between the charge delivered in *Simon* and that delivered here, and that the factual issues raised by the totally dissimilar indictment in *Simon* are materially different from those which this jury was called upon to resolve. For example, the indictment in *Simon* did not contain any charge relating to unaudited financial statements. In view of these substantial differences between the two cases, it is of no significance that we challenge here segments of the charge which are similar to portions of the *Simon* charge that were not challenged on that appeal. Indeed, what this appeal demonstrates is the danger that may arise when the trial court attempts to fit its charge in a case on trial into the mold of an earlier but dissimilar case.

A. Reckless Disregard

The Government attempts to sustain the court's reckless disregard charge here by asserting that it is similar to the charge given in *Simon*, and several other cases. Not only was this portion of the *Simon* charge not considered on appeal, but this Court said:

> "we do not have a case where the question is whether accountants may be subject to criminal sanction for

closing their eyes to what was plainly to be seen." 425 F.2d at 807.

In addition, *Simon* did not involve a situation where outside accountants were being held criminally responsible for statements contained in a company's unaudited statements, without any instruction concerning the differences between audited and unaudited statements.

As we stated in our principal brief, our primary assertion is that the reckless disregard charge should not have been given at all, because it had no relevance to the factual issues raised by the indictment. Apparently, the Government concedes that the reckless disregard charge was not relevant to the portion of the indictment that related to the lack of footnote disclosure of the contract write-offs in the audited statement of earnings (See our original brief, pp. 55-56). Rather, the Government asserts that the reckless disregard charge was justified by the events relating to the unaudited statement of earnings. Thus, the Government is resting the appropriateness of the entire reckless disregard charge as to the outside auditors on their alleged failure to take appropriate action to verify the accuracy of NSMC's unaudited statements.

Before turning to a review of the actual steps Natelli took in reviewing the Eastern commitment, we reiterate the position we have taken in our main brief that a reckless disregard charge is appropriate only if the evidence shows that the defendants acted "with a conscious purpose to avoid learning the truth". *United States* v. *Sarantos*, 455 F.2d 877, 882 (2d Cir. 1972); *United States* v. *Jacobs*, 475 F.2d 270, 287 (2d Cir.), *cert. denied*, 414 U.S. 821 (1973). We do not suggest that proof of knowledge of falsity cannot be established circumstantially, or that it would not have been appropriate for the trial court, if requested by the Government, to have charged the jury that in determining whether Natelli had *actual knowledge* that the proxy statement was false, it could consider any relevant fact

known to Natelli.* Our point here is simply that the introduction of the concept of "recklessness" into a charge where the issue is whether the defendant "willfully and knowingly" made false statements is limited to situations where the alleged reckless conduct manifests "a conscious purpose to avoid learning the truth." *United States* v. *Sarantos, supra.*

Here there was no such evidence, and, therefore, the reckless disregard charge should not have been given. The actions Natelli took in reviewing the Eastern contract cannot possibly be construed as evidencing a conscious purpose to avoid learning the truth. Natelli did not simply accept Randell's word that Eastern had signed a commitment letter, he obtained and examined the letter, questioned Kelly, a NSMC vice-president, about the commitment, examined the detailed proposal submitted to Eastern, and checked the time sheets of the account executive who handled the Eastern account and found that he had devoted over 100 hours to the Eastern program prior to the end of May. Although the Government chooses to characterize this thorough review of the situation as "the narrowest possible review,"** the Government does not suggest any additional step that Natelli did not take that would have led him to the "truth".

The Government's argument (p. 48) that "Natelli never requested or looked for any record that NSMC had actually performed some services for Eastern, or spent any

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* Thus the cases cited by the Government which indicate that the existence of suspicious circumstances may be relevant in deciding whether the Government has proved actual knowledge are inapposite. The question here is not whether a charge that the jury may consider known suspicious circumstances in proving actual knowledge of falsity is appropriate. The question here is whether the "reckless disregard" charge actually given by the Court was warranted by the facts.

** This argument underscores the prejudice flowing from the court's refusal to charge on the distinction between audited and unaudited statements.

money doing services for Eastern or that Eastern had previously expressed any interest in the proposal" is specious. As noted above, the programs of mailings and postings of advertisings on campuses to which Eastern committed itself in the letter were to take place during the coming academic year and, thus, under the method of accounting used, there would not be any such expenses yet recorded (See pp. 19-20, *supra*). Moreover, the Eastern proposal that Natelli examined indicated, on its face, that it had been submitted to Eastern, and the fact that the account executive spent over 100 hours working on this program was itself a strong indication that Eastern must have manifested an interest in these programs.

Thus, despite its quotation from *Jacobs, supra,* about the fact that there the defendant "did not take one of the simple means that would have led to the revelation of the truth", the Government does not suggest any significant step that Natelli did not take.* Indeed, the Government's brief now concedes (p. 47) that after seeing the Eastern letter, "Natelli temporized" and made his decision only "after seeing the NSMC proposal to Eastern and the time logs of an NSMC salesman relating to the making of the

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* Earlier, in discussing the sufficiency of the evidence as to the Eastern contract, the Government alludes to the fact that no direct contact was made with Eastern (Gov. Br. p. 31). In this section of the brief, the Government, no doubt mindful of the court's failure to discuss the auditors' limited responsibility for unaudited statements, makes a contradictory argument:

> "The Government's argument was *not* that Natelli was departing from any generally accepted standard of (limited) review responsibilities in not checking further. This is a straw man raised by appellants to buttress their appeal (see point B, below). (Gov. Br. p. 48. See also, *id.* at p. 54.)"

As is obvious from the discussion of the Mullen indictment *supra*, p. 21, any contact with Mullen to confirm what was in his letter would simply have produced another document acknowledging that Eastern had made this commitment in May. Indeed, such a confirmation was provided during the August 31, 1969, audit.

proposal."* In sum, the record is totally barren of any evidence that Natelli deliberately closed his eyes with a conscious purpose to avoid learning the truth and, thus, the reckless disregard charge was not warranted by the facts of this case. See *United States* v. *Sarantos, supra.*

In any event, as we demonstrated in our original brief (pp. 53-54), even if some form of reckless disregard charge was appropriate, the charge as given was seriously deficient. The Government's argument on this point ignores the clear teaching of this Court in *United States* v. *Sarantos, supra,* that a charge on the concept of reckless disregard should make clear to the jury that this concept applies only where the defendant's actions evidence a "conscious effort to avoid learning the truth". In *Sarantos* the trial court had charged the jury that they could find knowledge of falsity:

> "if you find that Mr. Sarantos acted with reckless disregard of whether the statements made were true or with a conscious effort to avoid learning the truth".

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* Despite its self-serving statement (p. 49) that "this was the Government's theory of Eastern, argued in one way or another from opening to summation", in fact, as the Government's citations to the transcript show, this is radically different from the argument used by the Government below. At page Tr. 2286 which the Government cites there appears the highly prejudicial comment about catching "that doctor at three o'clock in the morning down in his cellar burying a fresh corpse."—a statement diametrically opposed to the present theory of Natelli's "temporizing". The Government consistently argued below its theory that the Eastern contract magically appeared for the first time in the dark of the night at Pandick Press and was plugged right in for the Pontiac contract (Tr. 2268-2269, 2295-2296, 2304, 2311, 2359). Gx. 65-15, which was before the jury for many hours of the trial, stated in big handwritten letters that Eastern was "booked" on August 15th (the day of meeting at Pandick Press), and Judge Tyler restated the Government's argument to be "that Natelli didn't bat an eye and in went the Eastern figures" (Tr. 2359). The fact is that both the Government's argument and the Court's charge were at odds with the testimony of Buck and others (see pp. 35-36, *infra*), and the Government, having confused and prejudiced the jury, is now trying to dis-own such argument.

Despite the fact that the charge given by the court did refer to "a conscious effort to avoid learning the truth"—a statement completely lacking in the charge of the court below—this Court criticized the use of the disjunctive "or" stating:

> "The phrases 'reckless disregard of whether the statements made were true' and 'conscious purpose to avoid learning the truth' mean essentially the same thing. Cf. Model Penal Code § 2.02(2)(c) at 26. Therefore, any differences in meaning that might possibly result from the substitution of 'or' for 'and' would surely constitute harmless error. While we prefer the use of the connective 'and' because we think the repetition better impresses on the jurors' minds the importance of finding a deliberate disregard of the facts, we do not think our preference requires a new trial. Cf. United States v. Braver, 450 F.2d 799 (2d Cir. 1971). We do, however, urge the use of 'and' rather than 'or' in future charges on this issue."

In *United States* v. *Jacobs*, 475 F.2d 270, 287 (2d Cir.), *cert. denied*, 414 U.S. 821 (1973), the charge of the trial court which this Court approved stated:

> "Thus if you find that a defendant acted with reckless disregard of whether the bills were stolen *and with a conscious purpose to avoid learning the truth* the requirement of knowledge would be satisfied, unless the defendant actually believed they were not stolen." (Emphasis added.)

Thus, the very authorities cited by the Government*

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* The lengthy quote from the charge of the court in *United States* v. *Gottlieb*, 493 F.2d 987 (2d Cir. 1974), set out at p. 46 of the Government's brief is of no help to the Government, for there the Court stated:

> "Now, if he doesn't have knowledge, if he doesn't know whether or not he is in the National Guard but he still puts

(*footnote continued on following page*)

show that the charge given here was erroneous in that it failed to advise the jury of the need for a finding of "a conscious purpose to avoid learning the truth."

B. The Court Failed to Explain the Differences in an Outside Auditor's Responsibility for Audited and Unaudited Financial Statements

The Government again completely distorts the record in attempting to answer our argument, and that of the *amici* that it was error for the court to instruct the jury, as a matter of law, on the auditor's duty when performing an audit, without distinguishing that duty from the auditor's limited responsibility for a company's unaudited statements. First the Government contends that there was no evidence in the record of any distinction between an outside accountants' duties with regard to audited and unaudited figures. In fact the defense did elicit such proof (Tr. 305-306, 350, 792, 1534-1535, Gx. 13, E. 100-101). Moreover, the court chose to charge the jury as to an outside auditors' responsibilities in performing an audit, not as a factual contention of the parties,* but as a matter of law. Thus, the court should have also told the jury, as a matter of law, what the responsibility of an outside auditor was with regard to unaudited statements. See, e.g., *Fischer* v. *Kletz*, 266 F.Supp. 180 (S.D.N.Y.

(*footnote continued from preceding page*)

> the information down on the official form, then he has made a deliberately false statement. If he wilfully blinds himself to the fact, then there is a wilful and knowing misconduct. So if you find that the Government has proved beyond a reasonable doubt that the defendant either, first, knew he was not in the National Guard when he submitted a statement saying he was, or, second, that he didn't know whether or not he was in the National Guard when he represented, in fact, he was, then the element of knowing and wilful conduct is satisfied (*United States* v. *Gottlieb*, Appellant's Appendix at 1006a-1008a).

* The defense had also requested a factual contention on this issue but this request was not given (A. 206).

1967), *Gold* v. *D.C.L., Inc.*, [1973 Transfer Binder] CCH Fed.Sec.L.Rptr. ¶ 94,036 (S.D.N.Y.); *Seeburg—Commonwealth United Litigation*, [1972-73 Transfer Binder] CCH Fed.Sec.L.Rptr. ¶ 93,802 (S.D.N.Y. 1972).

The Government's contention that the charge requested by the defense was in fact given is supported by juxtaposing two portions of the charge, which were in fact separated by 26 pages of instructions, and by an abbreviated reference to actual charges requested by the defense. The charge requested by the defense would have had the court follow its statement of the auditor's duty when performing an audit with the statement:

> "As to the unaudited statement of earnings for the nine months ended May 31, 1969, the defendants had no responsibility to render an opinion that the statement fairly presented the results of the client's operations. The defendants' only responsibility as to this statement was to be satisfied that, as far as they knew, the statement contained no misstatement of material facts."

The error which we urged is that the charge given by the court as to the auditor's responsibility when performing an audit was not followed by any explanation of the different responsibility for unaudited statements. The fact that some 26 pages earlier in the charge the court told the jury that they had to find that the defendants knowingly and intentionally prepared false statements can not justify the refusal to give the requested instruction.

The Government's contention that counsel failed to object is also belied by the record which shows that in the middle of counsel's objection, he was cut off by the court and told he had an exception (Tr. 2384). Having submitted a specific charge on this point, defense counsel's failure to argue further with the court can hardly be considered a waiver of this point. See *United States* v. *Gallishaw*, 428 F2d 760, 763 (2d Cir. 1972).

The Government's suggestion (pp. 52-54) that the trial court was justified in refusing to give any instruction concerning unaudited statement liability because there is confusion as to the standard of liability is specious since the defense request that was submitted was based on the very standard which the trial court had set out in its earlier opinion in *Fischer* v. *Kletz, supra.*

Finally, the contention that the court's charge as given does not extend accountants' liability (pp. 54-55) is supported only by a citation to *Simon,* which did not involve unaudited statements. In addition, in making this argument the Government itself confuses work done by appellants on the audited statements in the proxy with issues relating only to the unaudited statements. If sophisticated Government lawyers, after extended study of this case, failed to comprehend the differences in the work performed on the audited and unaudited statements, it is unreasonable to assume that a lay jury could have drawn these distinctions.

C. The Court Refused to Correct Vitally Important Misstatements in the Charge Concerning the Eastern Contract and Failed to Respond Properly to a Note From the Jury Indicating That They Had Been Completely Misled by These Misstatements

The Government attempts to answer our carefully documented argument that the jury was misled by the court's misstatement of the testimony of the witness Buck by misstating in its brief what occurred. Thus, the Government says that all the court did was misstate the fact "that the witness Buck had given evidence that the actual paperwork in booking Eastern was performed [at the printer]". As is demonstrated by the quotations from the transcript set forth in our original brief, the court's error was in stating that Buck testified that the decision to allow the company to accrue income on the Eastern contract was made at the

printer when, in fact, Buck had said that Natelli did not make any decision at that time. It was this key factual error which diverted the jury from a proper assessment of Natelli's defense that his good faith was established by the steps he took during the following week before acquiescing in the company's decision to report income on the Eastern contract. Moreover, the Government's argument that the error "was completely harmless in view of the fact that the jury remembered the evidence to be different" (p. 56) completely distorts the jury's note which said "most of us recall the testimony" as misstated by the trial court.

D. The Court Erroneously Charged the Jury That in Determining Whether the Audited Statements Were Materially False, They Should Consider the Footnote Alone

In answer to our contention that the trial court erroneously told the jury that the crucial question was whether the footnote fairly presented the financial position of the company, the Government first asserts that this was a correct test and then alleges that the court did say that the issue of materiality had to be decided on the basis of the financial statement as a whole and not just the footnote.

At page 65 of our opening brief, we cite a number of cases which clearly establish that issue of materiality must be determined on the basis of the overall financial statement, and we shall not repeat those citations.

The Government's attempt to sanction the charges as given here by comparing it with an isolated portion of the charge in *Simon* is nonsense, since the court specifically charged in *Simon:*

> "The critical test, therefore, is whether the financial statement here, as a whole, fairly presented the financial condition of Continental as of September 30, 1962, and whether it accurately reported the operations for fiscal 1962." (*Simon* Appendix 3523A)

It is the failure of the charge here to properly focus the jury's attention on this critical issue which, we submit, constitutes reversible error.*

E. The Court Erred in Not Instructing the Jury That it Must Find That Defendants Knew That the Alleged Misstatements Were Material

In our opening brief our argument was two-fold. First, Section 32(a) requires that such a charge be given since, with reference to knowledge, it makes no distinction whatsoever between the elements of falsity and of materiality.** This charge is also required by Section 23(a) which provides that good faith compliance with any rule or regulation of the SEC is a complete defense in an action under the Securities Exchange Act and by Rule 3-02 of the SEC's accounting rules, Regulation S-X, which provides that an item which would otherwise have to be separately disclosed need not be shown if the amount involved is not "material".

Second, we argued that for the issue of culpability to have any meaning in the context of this case—because of the nature of accounting which involves repeated professional judgments on the question of materiality—a jury must be instructed that a defendant accountant must be found to have known that an item omitted or not separately stated was material.

The crux of the Government's response is that accountants should not be permitted to make "purposeful, deliberate lies" with respect to "immaterial matters". This

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* The Government's argument that no reasonable juror who heard the entire charge could have concluded that he was to judge the materiality of the footnote in isolation (Gov. Br. p. 59) must be judged in light of the fact that defense counsel who had just heard the entire charge objected for precisely this reason (Tr. 2383).

** *See also* Section 2.02(4) of the A.L.I. Model Penal Code (1961), which provides:

> "When the law defining an offense prescribes the kind of culpability that is sufficient for the commission of an offense, without distinguishing among the material elements thereof, such provision shall apply to all the material elements of the offense, unless a contrary purpose plainly appears."

argument totally misperceives the nature of accounting and the function of an accountant. As demonstrated, SEC regulations, accounting principles and judicial decisions all have recognized that an item which is not material need not be separately dealt with. Thus, contrary to the Government's assumption, these "purposeful, deliberate lies" about "immaterial matters" are not "lies", but are ordinary, everyday accounting judgments. All auditors make such judgments on materiality, and under the government's theory, if they are wrong, they are criminally liable regardless of whether they had a culpable state of mind. The Government's "little lies" argument demonstrates its confusion about our position and emphasizes the danger inherent in the lower court's failure to give the requsted instruction. There is no reason to assume that a jury of laymen was any less confused than the Government is by the charge which was given.

The weakness of the Government's argument is further underscored by the cases upon which it relies. For instance, although *United States* v. *Feola*, 43 U.S.L.W. 4404 (U.S. March 19, 1975) did hold that knowledge of every element of a crime was unnecessary as the Government here contends, its holding was specifically based on the absence in the statute under consideration there of a "knowledge" requirement. In contrast Section 32(a) expressly requires knowledge.*

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* Similarly, the Government's reliance on *United States* v. *Schwartz*, 464 F.2d 499 (2d Cir. 1972), *cert. denied*, 409 U.S. 1009 (1973) is misplaced since that case, unlike the present case, was brought under that part of Section 32(a), which does not require that knowledge be shown. *Schwartz* also involved no question of materiality. *Schwartz* is relevant to this case, however, in that it clearly demonstrates that "intention" is not the equivalent of "knowledge" since it held that one can intend to commit an illegal act without possessing knowledge of its illegality, and thus, that any instruction relating to the need to find an intention to misstate a material fact which may have been given here did not, as a matter of law, convey to the jury that it must also find that defendant knew that the fact was material. *Id.* at 509. *See also United States* v. *Peltz*, 433 F.2d 48, 54-55 (2d Cir. 1970), *cert. denied*, 401 U.S. 955 (1971).

Equally as shocking as the Government's citation (or perhaps more appropriately miscitation) of *Feola,* is its reliance on *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973). *Chris-Craft* did, as the Government suggests, identify materiality and culpability as distinct concepts. We do not contend otherwise. However, by claiming that *Chris-Craft* holds that the standard of materiality is solely objective, the Government focuses on the wrong aspect of that opinion. We did not argue for the elimination of an objective standard of materiality, we argued that culpability, in the context of this case, could not reasonably be determined absent consideration of defendants' knowledge of materiality. Since *Chris-Craft* expressly considers culpability in terms of the duty undertaken by a defendant, it is in total accord with this position. 480 F.2d at 363.*

Finally, the Government relies on widely dispersed parts of the lower court's instructions, takes them totally out of context, and claims that the jury was instructed tha a finding of knowledge of materiality was necessary in order to convict. We submit that this charge, which was expressly requested by defendant and which request was expressly denied, was not given and that the charge as a whole cannot fairly be said to have conveyed the substance of defendant's requested instruction. The Government cannot and does not rebut the fact that in every instance in which the lower court instructed the jury on what type of "knowledge" it

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* The Government's misunderstanding of which aspect of the *Chris-Craft* decision is relevant here, apparently has resulted in its further misuse of this Court's decision in *United States* v. *Simon, supra.* In *Simon,* the issue was whether purported compliance with generally accepted accounting principles could constitute a complete defense on the issue of objective materiality. No question was presented as to whether an accountant's failure to separately set forth an item because of his good-faith, but mistaken professional judgment that the item was not material could be the basis for a finding of the existence of a culpable state of mind sufficient to support a criminal conviction. *Id.* at 306.

would have to find in order to convict, no reference to materiality was ever made (Tr. 2426, 2363, 2400). Although we recogize that review of the entire charge imposes a burden upon this Court, we respectfully request that, because of the significance of this issue, the Court read the charge and determine for itself whether, based on the charge given, the jury could possibly have had before it the issue of whether defendants knew that the item which they allegedly failed to separately set forth was material.

F. The Court Failed to Charge the Jury That They Must Be Unanimous as to the Particular Specification of Falsity

In support of its contention that it was not error for the court to refuse defense counsel's request that the jury be instructed that they must be unanimous as to the particular specification of falsity on which they based their verdict, the Government again distorts the record by stringing together two portions of the charge which are forty pages apart (Gov. Br. p. 62). In addition the Government relies on several decisions from other circuits which held only that the failure to give such a charge was not plain error, *Vitello* v. *United States*, 425 F.2d 416, 422-423 (9th Cir.), *cert. denied*, 400 U.S. 822 (1970); *United States* v. *Edwards*, 443 F.2d 1286, 1291-1292 (8th Cir.), *cert. denied*, 404 U.S. 944 (1971)*, or in which the jury's verdict on other counts showed that it had, in fact, been unanimous as to a particular specification in the count at issue, *United State* v. *Friedman*, 445 F.2d 1076, 1083-1085 (9th Cir.), *cert. denied*, 404 U.S. 958 (1971). In view of the specific objection here and the fact that there is no way of telling whether the jurors did, in fact, unanimously agree on a single specification of falsity, the conviction here should be reversed. See *Glenn* v. *United States*, 420 F.2d 1323

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* It is not clear from the decision in *United States* v. *Cook*, 497 F.2d 753, 759 (9th Cir. 1972), whether this precise issue was raised at the trial level or even in the circuit court.

(D.C. Cir. 1969); *State* v. *Oswald,* 306 S.W.2d 559, 563 (Mo. 1957).

G. The Court Gave A Charge on A Theory of Motive Not Supported by the Evidence or Even Argued by the Government

The Government attempts to justify the court's charging the jury that the defendant's motive could be found in the desire to retain a valuable client, despite the lack of any proof to that effect, by quoting an argument from the prosecutor's summation made in response to an argument by defense counsel on a totally different issue. In attempting to strain the record to convince the court that this theory of motive was one which was at issue at trial, the Government fails to mention that in its own request to charge on motive, the Government stated:

> "A scheme to defraud is often motivated by a desire for gain. In this instance, however, the defendants did not stand to realize any financial gain as a result of the financial statements in the proxy statement. Neither of the defendants would have received increased remuneration or increased participation in fees as a result of preparing the proxy statement in one form rather than another.
>
> "The government, however, contends that the defendants were motivated by the desire to conceal their past negligence in certifying NSMC's 1968 statements, which statements, according to the government, the defendants had learned were wholly inaccurate some months after they were prepared."* (A. 163)

Thus, there was no basis for the court to tell the jury that one of the motives the defendants had was the desire to retain a valued client.

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* This was the same and only theory of motive advanced in the Government's opening (Tr. 34).

POINT III

Evidence of a good faith error in computing the deferred tax credit was improperly received as proof of fraud.

Apparently recognizing that it has no real answer to our argument that it was improper for the Government to introduce the appellants' SEC testimony that a good faith error had been made in May 1969 when the deferred tax credit was determined and then to argue in summation "that tax credit is a phony", the Government attempts to sluff off this argument in a footnote which misstates our contentions in this regard. (See footnote Gov. Br. p. 28).

As we noted in our original brief, we do not dispute the proposition set forth in the cases cited by the Government that evidence of other crimes may be relevant as proof of knowledge and intent. See, e.g., *United States* v. *Papadakis,* Docket No. 74—1847 (2d Cir. Jan. 10, 1975). Our argument—which the Government does not answer—is that such evidence is admissible only where the proof establishes that the other conduct was in fact criminal.

As this court recognized in *United States* v. *Brettholz,* 485 F.2d 483, 487 (2d Cir. 1973), *cert. denied,* 415 U.S. 976 (1974):

> "the problem is not merely one of pigeonholing, but one of balancing, on the one side, the actual need for the other-crimes evidence in the light of the issues and the other evidence available to the prosecution, *the convincingness of the evidence that the other crimes were committed and that the accused was the actor,* and the strength or weakness of the other-crimes evidence in supporting the issue, and on the other, the degree to which the jury will probably be roused by the evidence to overmastering hostility."

Quoting McCormick, Evidence § 190 at 453 (2d ed. 1972) (Emphasis added).

Here, the unchallenged testimony of Mrs. Raimondo was that she was the person who determined in May of 1969 that substantially all of the original $190,000 deferred tax provision was unnecessary. Mrs. Raimondo, who was no longer employed by PMM was neither indicted nor impeached on the witness stand. This is why it was so unfair for the Government to introduce the defendants' SEC testimony and then argue that the "tax credit is a phony" (Tr. 2316).

POINT IV

Polygraph testimony should have been received on the issue of lack of knowledge and willfulness.

The Government contends that we are asking the Court "to upset the long-standing precedent of *Frye* v. *United States*, 293 Fed. 1013 (D.C. Cir. 1923), holding that polygraph evidence is inadmissible in federal criminal trials" (Gov. Br. p. 71). On the contrary, we ask that the open-mindedness of the law to scientific developments that was expressly encouraged fifty years ago in *Frye* be accepted by this Court. The District of Columbia Circuit explained in the *Frye* case in 1923 (293 Fed. at 1014):

> "Just when a scientific principle or discovery crosses the line between the experimental and demonstrable stages is difficult to define. Somewhere in this twilight zone the evidential force of the principle must be recognized. . . ."

We do not deny, of course, that the Government can cite more decisions excluding polygraph evidence than we can cite admitting it. But that, we submit, is not the point. In establishing the principle governing the admissibility of

expert evidence, Rule 702 of the new Federal Rules of Evidence declares in deliberately broad language:

> "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise."

Thus, the question whether expert polygraph testimony shall be received must be decided, in light of the state of the art and the importance of the evidence. To make that judgment turn purely on abstract precedents, as the Government suggests, is to disregard the practical standard of *Frye* and the truth-oriented flexibilty of the Federal Rules of Evidence. By ruling that such evidence is never admissible, the district judge erroneously foreclosed us from any opportunity to satisfy the *Frye* standard. See *United States* v. *Oliver*, 492 F.2d 943, 944 n. 1 (8th Cir. 1974).*

POINT V

Dismissal of the indictment is warranted because of deliberate misconduct by a senior Government official involved in this prosecution.

The Government does not—and cannot—take issue, with the proposition, recognized by this court and others and developed in our opening brief (pp. 86-90) that deliberate

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* The Government makes the fall-back argument that, even if polygraph evidence is admissible, the district judge had discretion to exclude it and there has never been an appellate finding that such a decision constituted "an abuse discretion" [sic] (Brief at 73 note). But the Government argued below and the district judge held that polygraph evidence is inadmissible as a matter of law: "I note that there is no authority in this circuit for the admission of such evidence" (opinion p. 7). Thus, the district judge never exercised any *discretion* in concluding that he had no authority to admit the evidence.

misconduct by a Government official calculated to affect a pending criminal case may be grounds for dismissal of the indictment, without regard to a showing of actual "prejudice" to the defendant. Instead, the Government tries to minimize the SEC Chief Accountant's actions so that they would not constitute misconduct. Regrettably this attempt too rests on a distortion of the facts of record.

The Government argues that Chief Accountant Burton, who by his own statement was involved in the decision to refer this case for prosecution, "was in no way referring to the merits of the case or commenting on the defendants' guilt or innocence" (Gov. Br. 74 n.). That characterization simply cannot be squared with the Chief Accountant's own explanation, submitted to the court below (Ct. Ex. 2) in the form of an unsworn memorandum, in which he acknowledged that the published statement—"if we can't get a conviction here, we never will."—"was certainly consistent with the sense of the conversation."

The Government next contends that the statement was not made "under circumstances indicating a desire to affect the trial" (Gov. Br. p. 75):

> "This was not a press release or a press conference, but a comment at an informal lunch with a personal friend. " (*Ibid.*)

The atmosphere of unofficial casualness the Government seeks to convey is sharply at odds with the facts. Again, Chief Accountant Burton's own memorandum (Ct. Ex. 2) belies the Government's *post hoc* whitewash. He explains how he came to meet with the *Journal* reporter by saying that the reporter, Fred Andrews, called to ask to "get together for a general *background* discussion of what we were doing in the accounting and disclosure areas" (emphasis added); Burton also noted:

> This was not an unusual request since such meetings have been held on several occasions in the past *in light*

> *of the Mr. Andrews' responsibilities* as accounting reporter for the *Wall Street Journal.* (Emphasis added).

A further indication that what was involved was an official but anonymous interview, not the "informal lunch with a personal friend" conjured in the Government's brief, is Burton's report that the luncheon meeting also included Ken Bacon of the *Wall Street Journal's* Washington staff and A. Clarence Sampson, Jr., the SEC's Associate Chief Accountant. By Burton's own admission, the conversation dealt almost exclusively with his and the SEC's official actions, and his discussion of the present case, the trial of which was imminent, arose in the context of his effort "to explain the criteria used to determine what might be a criminal case. . . ."

As we discussed at some length in our main brief, the courts have not only the power but the duty to develop appropriate sanctions for the purpose of deterring and punishing improper conduct by senior government officials that endangers the constitutional rights of the accused. Elusive inquiries into "actual" prejudice have clearly failed to stop such misbehavior.* While the Government

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* Apparently on some theory of mutual cancellation, the Government contends (p. 78) that no sanction should be imposed against Chief Accountant Burton's conduct in light of the "extensive publicity inspired by the defense." This conclusion is supported by the statement that Peat, Marwick, Mitchell & Co. "from the day of indictment *through* the day of sentencing conducted a publicity campaign." (Emphasis added.) At the time of the indictment, PMM issued a short press release and mailed a fourteen-page statement in response to the indictment's allegations to its clients. (In the previous year, another firm of professional accountants, Arthur Andersen, followed a similar procedure in replying to the Four Seasons indictment.) The Government references to the fourteen-page statement is not supported by record citation because the statement was not referred to below nor was there any

(*footnote continued on following page*)

underscores that this misconduct does not involve a "press release or a press conference", that fact only aggravates the problem. The calculated leak by an anonymous Government official giving a "backgrounder" to a reporter raises one set of issues when foreign or domestic policy is involved, but quite another set of problems when the official has played a major role in a criminal investigation and the leak relates to a pending criminal case. It is harder to devise personalized sanctions or to expect real deterrence when the identity of the official involved remains concealed. Although it was possible to track down the identity of the "Washington source" in this case, that fortuitous success should not divert the court from taking strong prophylactic measures to convince the Government that this kind of conduct is an intolerable threat to fundamental constitutional rights. In this case of at most marginal evidence of culpability on the part of the defendants, use of the sanction of dismissal would be an especially effective and appropriate method of vindicating the overriding public interest at stake.

(*footnote continued from preceding page*)

criticism of the press release. In fact, the Government possesses the statement to clients because it was requested from PMM's general counsel (Mr. Earle) by Harold F. McGuire, the Assistant U.S. Attorney who was then in charge of this prosecution. At that time, Mr. McGuire stated to Mr. Earle that he had "no problem" with either the press release or the statement to clients.

As for the other Government contention that the so-called publicity campaign continued from the day of indictment through the day of sentencing, precisely the opposite is what actually occurred. Not one other word was uttered by PMM for the next ten months until after the conviction, at which time a three-sentence release was issued. Indeed, the firm did not make any statements during the trial—even in response to the remarkable Wall Street Journal article in which Mr. Burton was quoted and which mistakenly headlined the firm as a defendant.

Moreover, whatever the merits of PMM's actions, they were not the actions of the defendants and, more important, they were not the actions of a Government official.

POINT VI

The indictment should have been dismissed and a judgment of acquittal entered because of the government's inability to prove proper venue.

In straining to sustain venue of this prosecution in the Southern District of New York* the Government places principal reliance on the "continuing offense" provision of 18 U.S.C. § 3237(a) which it says "supplements" the specific venue statute provided in the 1934 Securities Exchange Act, 15 U.S.C. § 78aa. But the Government cannot slide around Section 78aa quite that easily for Section 3237(a) begins: "*Except as otherwise expressly provided* by enactment of Congress", a continuing offense can be prosecuted wherever it was "begun, continued, or completed" (Emphasis added).** But by providing in the 1934 Act that venue shall lie where "any act . . . constituting the violation occurred", the Congress *has* otherwise expressly *provided*. *Investors Funding Corporation of New York* v. *Jones*, 495 F.2d 1000 (D.C. Cir. 1974).

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* The extent to which the Government strains in attempting to sustain venue is evidenced by the fact that it completely misstates the record when it says that:

> "Natelli argues that the indictment should be dismissed, claiming that venue for a charge under Section 32 of the Securities Exchange Act, 15 U.S.C. § 78ff, could not properly be laid in the Southern District of New York. At trial, the Government proved that defendants Natelli and Scansaroli actually prepared both the false footnote and the false nine month earnings statement at the Pandick Press in Manhattan."

While work was done in Pandick Press in New York, the evidence shows that the footnote was prepared by Natelli and discussed with Otkiss before he went to New York and the decisions as to the Eastern contract and the contracts questioned by Oberlander were not made until the week after Natelli returned to Washington from Pandick Press (Tr. 682-683, 539-541).

** With two exceptions discussed below, every case cited by the Government in its brief had been analyzed and discussed in our opening brief and shown to be materially distinguishable from the case at bar and/or supportive of our position. Since the Government's brief simply glosses over the problems with its reliance on many of these cases, we respectfully refer the Court once more to our opening brief on this subject.

The Government suggests that venue in New York was proper even if "the offense charged is only completed upon the presentation of the false proxy statement to the SEC in Washington",* citing two cases, neither of which is helpful to the Government's position because, for example, neither involved a securities law violation and thus neither dealt with or discussed the applicable venue statute, 15 U.S.C. § 78aa. The principal case relied on by the Government, *United States* v. *Bithoney*, 472 F.2d 16 (2d Cir.), *cert. denied*, 412 U.S. 938 (1973), must be cited with tongue-in-cheek, for there the defendant charged with violating 18 U.S.C. § 1015(d) by making a false acknowledgment in Boston on an immigration form later filed with the Immigration and Naturalization Service in Buffalo argued that he should have been prosecuted in Boston, *not* in Buffalo. As the Government accurately states in its brief (at p. 80): "The Court held that since the offense charged was not completed until the false document was submitted, venue there was proper." That, of course, is precisely what appellant Natelli argues here about venue of this securities charge.

The Court explained in *Bithoney:*

> To hold that the mere writing out of a false acknowledgement which is immediately destroyed and never filed, presented or in any way used to obtain relief in any court or administrative agency seems to us to be a result that was never contemplated by Congress when this statute was enacted. 472 F.2d at 22.

The statute at issue here prohibits the making of a false statement in a document filed *with the SEC*. Can it be argued that this offense was committed—or in the words of the venue statute, that the "act or transaction constituting the violation occurred"—when the allegedly false proxy statement was *drafted* in New York or even when the printing of it was completed there? Obviously not. If the

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* Brief at 80.

proxy statement was not filed with the SEC in Washington, a prosecution for "making" a false statement therein could never have been countenanced. Necessarily therefore the essential element without which there has been no offense is *filing.**

Since this Court in *Bithoney* expressly relied on *Travis* v. *United States*, 364 U.S. 631 (1961), as controlling the decision (472 F.2d at 24) it is certainly extravagant for the Government to assert in its brief (Gov. Br. p. 82) that in its decision in *United States* v. *Slutsky*, 487 F.2d 832 (2d Cir. 1973), *cert. denied*, 416 U.S. 937 (1974), "this Court has limited the *Travis* decision to its peculiar facts."**

Appellant Natelli was indicted for violating Section 32, by making a false statement in a proxy statement which was, like the non-communist affidavit in *Travis*, only indirectly required to be filed—unless such a document is on file proxies may not be solicited. (See our opening brief p. 95.) There could be no offense under *this* statute until the proxy statement was actually filed and only at that point was the violation (if any) "committed" within the meaning of 15 U.S.C. § 78aa. Thus, just as in *Travis*, both for purposes of substantive liability and for venue, this charge was not a "continuing offense" that could be prosecuted in a district where at most only preparatory conduct (and not even mailing) had taken place. See, *e.g.*,

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* The Government argues that, by discussing the decision in *United States* v. *Newton*, 68 F. Supp. 952 (W.D. Va. 1946), *aff'd*, 162 F.2d 795 (4th Cir. 1947), *cert. denied*, 333 U.S. 848 (1948), this Court in *Bithoney* in effect held that venue would also have been proper in Boston, where the allegedly false document was prepared. Apart from the fact that as already shown in our opening brief (at p. 96 note) *Newton*, a tax case, is not precedent under the distinct venue provision of the securities laws, the Court in *Bithoney* expressly acknowledged that "We are not required to decide if venue would have been proper in Massachusetts." 472 F.2d 16.

** See the discussion of *Travis* and *Slutsky* in our opening brief at pp. 94-96.

Reass v. *United States*, 99 F.2d 753 (4th Cir. 1938) (prosecution under 12 U.S.C. § 1441(a)); *United States* v. *Borow*, 101 F.Supp. 211 (D.N.J. 1951); *United States* v. *Valenti*, 207 F.2d 242 (3d Cir. 1953); *United States* v. *Mischlich*, 310 F.Supp. 669 (D.N.J. 1970), *aff'd*, 445 F.2d 1194 (3d Cir. 1971), *cert. denied*, 404 U.S. 984 (1971), (prosecutions under 18 U.S.C. § 1001).*

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* The government misstates the Court's holding in *United States* v. *Candella*, 487 F.2d 1223 (2d Cir. 1973), *cert. denied*, 415 U.S. 977 (1974), which it says (Gov. Br. p. 83) "held venue to be proper in a district other than the one of filing, even though that case involved a violation of 18 U.S.C. § 1001 as did *Travis*." We point out again that in the present case we are dealing with the special venue statute for alleged violations of the securities laws, not 18 U.S.C. § 3237(a), but in any event the Court in *Candella* held only that when forms for government reimbursement were presented to officials in Brooklyn who maintained a branch office there "for the convenience of parties seeking to file papers with the Department" and were then forwarded "to the central office in Manhattan for examination and payment," venue under the false filing statute was proper in the federal court in Manhattan. Although the Court suggested that venue *might* have been proper in Brooklyn as well, the reference to possible prosecution in Brooklyn could be helpful to the government here only if there were evidence that appellants sought to file the NSMC proxy with the SEC's regional office in New York, which then forwarded it to Washington for a more official filing. But that is simply not the evidence.

In its discussion of the Court's decision denying mandamus in *United States* v. *Griesa*, 481 F.2d 276 (2d Cir. 1973), the Government distorts the decision. It is quite true, as indeed we argued in our opening brief (at 92-93), that the dissent of Judge Timbers (the author of the opinion in *Slutsky* on which the Government relies) dealt with the impropriety of transferring that case to a venue where only preparatory acts, and not the filing with the SEC, had taken place. But it is unwarranted for the Government to argue (Gov. Br. p. 82) that by denying mandamus, "this Court implicitly found that venue of the false filing counts could properly be laid outside this district where the filing had occurred." The majority denied mandamus on jurisdictional grounds, holding that it had no jurisdiction to review what *the Government* there argued "to be an incorrect decision" since it constituted only "an interlocutory order in a criminal case which did not have the effect of dismissal." 481 F.2d at 278.

Finally, the Government argues that even if the situs of the filing is the proper district for venue under 15 U.S.C. §§ 78aa and 78ff, venue could be sustained in the Southern District of New York on the theory that appellants engaged in "accessorial acts" in that district (Gov. Br. p. 84). We rely on the discussion in our main brief (at 96-97) as exposing the dual fallacies in this argument. First, a person cannot be both a principal and his own aider and abettor;* if the jury was led to believe that appellant Natelli was a principal, then venue in the Southern District of New York was demonstrably improper. Second, to the extent the Government's theory was that appellants Natelli and Scansaroli were aiders and abettors, then as shown in our opening brief (at 97 note *) and in appellant Scansaroli's opening brief (at 53-57), both convictions are fatally infected because of the complete absence of any instructions to the jury, requested by both the prosecution and the defense, explaining what does, and what does not, constitute *criminally* "aiding and abetting" as distinguished from merely being an innocent dupe used by others to commit a crime. Certainly the Government by this sort of *ipse dixit* about what the evidence allegedly showed cannot pretend that the jury made indispensible findings on the venue element under a theory of venue never explained to them.

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* The Government's argument on this point is inconsistent with the following argument found at p. 69 of its brief in response to the argument that the court failed to instruct the jury properly on the concept of aiding and abetting:

> "Defendant was convicted under 15 U.S.C. § 78ff, which provides for criminal sanctions against any person who 'wilfully and knowingly makes or causes to be made' false and misleading statements as prohibited by the Securities Exchange Act. Where the statute itself prohibits the causing of the crime, aiding and abetting need not be additionally and specifically charged. *United States* v. *Colasurdo*, 453 F.2d 585, 595 (2d Cir. 1971), *cert. denied*, 406 U.S. 917 (1972); *Cf. United States* v. *Berlin*, 472 F.2d 1002, 1009 (2d Cir.), *cert. denied*, 412 U.S. 949 (1973)."

Conclusion

As we noted in our original brief, even though some of the errors we cite relate only to one or two of the specifications of material falsity set forth in the indictment, the finding of error as to either specification requires reversal of the conviction since it cannot be determined which specification provided the basis for the jury's verdict. For all of the reasons set forth herein, in our opening brief, as well as the briefs of Joseph Scansaroli which we have adopted, the conviction of appellant Natelli should be reversed and the indictment should be dismissed.

Repectfully submitted,

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Seamarole
Exh 36
4/12/71 JW T.J.S

August 14, 1969

Mr. Robert C. Bushnell
National Student Marketing Corporation
345 Park Avenue
New York, New York

Dear Bob:

This is to confirm our verbal commitment given to you on May 14, 1969.

We will accept and utilize during the fiscal year, 1970, an amount of not less than $820,000 for National Student Marketing Corporation's services as offered to us in your proposal originally submitted on May 7, 1969.

We look forward to continued success in our youth marketing efforts and to our relationship with National Student Marketing Corporation.

Best regards,

Thomas E. Mullen
Manager-Special Markets

TEM:jla

Copy rec'd
Jpnkelie
4/9/75